In The

SUPREME COURT OF THE UNITED STATES

October Term, 1980

No. ____

[illegible]

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

AND APPENDIX

[illegible]

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In The

SUPREME COURT OF THE UNITED STATES

October Term, 1960

No.

ROSALIE M. SCHUBERT,
Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:

ROSALIE M. SCHUBERT, the petitioner herein, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fourth Circuit entered on January 17, 1961, which judgment affirms the decision of the Tax Court of the United States entered in the above entitled case on March 23, 1960.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Fourth Circuit is reported at 286 F.2d 573 (1961) and is printed in the Appendix herewith (App. 1). The findings of fact and opinion of the Tax Court of the United States are reported at 33 T.C. 1048 (1960) and are also printed in the Appendix herewith (App. 22).

JURISDICTION

This proceeding involves deficiencies determined by the respondent in petitioner's income tax for the taxable years ended December 31, 1953, 1954 and 1955, in the respective amounts of $672.63, $2,938.13 and $2,782.92. By decision of the Tax Court of the United States entered under date of March 23, 1960 the determination of the Commissioner of Internal Revenue was affirmed, and on petition to review the decision of the Tax Court, the United States Court of Appeals for the Fourth Circuit affirmed the decision of the Tax Court. The judgment of the United States Court of Appeals for the Fourth Circuit is dated and was entered on January 17, 1961 and is printed in the Appendix herewith (App. 21). The jurisdiction of this Court is conferred by 28 U.S.C. Sections 1254(1) and 2101(c).

QUESTIONS PRESENTED FOR REVIEW

1. Whether the life beneficiary under a testamentary trust, who is required to return for income taxation under Subtitle A, Chapter 1 of the Internal Revenue Code of 1939, and Subtitle A of the Internal Revenue Code of 1954, respectively, income of the trust distributed or distributable to her, including rents from property which the testator

had demised on a long-term lease and on which the lessee had erected a building, is entitled in computing taxable income as a deduction from gross income to an allowance under Section 23(l) of the Internal Revenue Code of 1939 and Section 167(a) of the Internal Revenue Code of 1954 measured by the depreciation of such building.

2. In the alternative, and in the event it is determined that such life beneficiary is not entitled in computing taxable income as a deduction from gross income to an allowance for depreciation of such building, whether she is entitled as a deduction from gross income to an allowance under said sections measured by amortizing any premium value of the lease on the land.

STATUTES INVOLVED

The statutes involved in this proceeding are Sections 23, 23(1) and 23(n), 113(a)(5); 113(b) and 114(a) of the Internal Revenue Code of 1939 (26 U.S.C. 1952 ed., Sections 23, 113 and 114) and Sections 161, 167, 1011 and 1014 of the Internal Revenue Code of 1954 (26 U.S.C. 1958 ed., Sections 161, 167, 1011 and 1014). The pertinent text of the 1954 Code sections are printed in the Appendix herewith (App. 43).[1]

STATEMENT OF THE CASE

Petitioner's mother, Gazelle K. Millhiser, owned a parcel of improved real estate in the business district of Richmond, Virginia, known as No. 409 East Broad Street.

[1] The corresponding provisions of the Internal Revenue Code of 1939 applicable here to the year 1953, are to like effect and therefore have not been printed.

The property had a frontage on the south side of Broad Street of 19.04 feet with a depth of 138 feet and began 61.36 feet east of the intersection of Broad and Fourth Streets.

On October 2, 1941, Mrs. Millhiser leased this property with improvements to G. C. Murphy Company for a term beginning on November 1, 1944, and at approximately the same time G. C. Murphy Company entered into two other leases with the owners of properties adjacent to the west and to the rear and extending 61.36 feet to the corner of Fourth and Broad Streets. The three leases were for terms ending in each case on January 31, 1973 and permitted G. C. Murphy Company to demolish the buildings on the three properties, to use or sell the salvage materials and to construct one department store building on the three properties.

The Millhiser lease provided for a monthly rental of $1,000. per month through January, 1948; $1,145.83-1/3 per month thereafter through January, 1958; and $1,208.33-1/3 per month thereafter through January, 1973. The tenant agreed at the end of the term to erect individual walls along the boundary lines of the property, to restore separate water, sewer and power lines and other facilities so as to make the building upon the Millhiser property a separate rental unit.

On or about May 1, 1947 demolition of the existing improvements was begun by G. C. Murphy Company and was immediately followed by construction of one department store building on all of the several demised properties. This building, consisting of a basement and five (5) stories, was completed on or about July 1, 1948, at a total cost of $1,442,969.

The cost of that portion of the building constructed on the Millhiser property was estimated to be between $150,000. and $180,000. and was borne by the tenant, except to the extent of any salvage value recovered by the tenant from demolition of the former building thereon.

The cost to Mrs. Millhiser of the improvements upon the demised property at the time of their demolition on May 1, 1947, after depreciation, was $6,200. She claimed for income tax purposes on account of depreciation of the demolished improvements a deduction at the rate of $240.77 annually from May 1, 1947, until her death.

Mrs. Millhiser died on August 31, 1953 and under her will petitioner was named the life beneficiary of a trust to the corpus of which the executor allotted 409 East Broad Street, Richmond, Virginia.

The property was appraised as of the date of decedent's death by three qualified real estate appraisers at a value of $200,000. The appraisal was arrived at in light of sales of similar property in the same block during the year 1953. In the Federal estate tax return filed by the executor the property was reported at a value of $200,000. and the estate tax paid thereon. The return was audited without adjustment in the value of the property, and the $200,000. value of the property as of the date of the decedent's death is accepted by the respondent.

In 1953, the property was assessed for local real estate taxes at $272,640. of which $138,430. was assigned to the land and $134,210. to the improvements. As of August 31, 1953 the value of the property was approximately equally divided between land and improvements.

The trustee paid to the petitioner the net annual income from the trust as computed by him since August 31, 1953, and as her attorney-in-fact, filed income tax returns for her for the years in question. These returns report as trust income distributed to petitioner the net rents from 409 East Broad Street, as follows:

	1953	1954	1955
Gross rents	$4,583.32	$17,422.61	$17,422.31
Less:			
Real Estate Taxes	——	6,118.56	6,118.22
Insurance	7.54	12.32	93.59
Commissions	275.00	825.00	825 00
Depreciation	1,666.67	5,000.00	5,000.00
Net rents	$2,634.11	$ 5,466.73	$ 5,385.00

Deductions for depreciation upon the improvements on 409 East Broad Street were at the rate of $5,000. per annum, computed by assigning to them a value of $100,000. and a useful life of twenty (20) years ending approximately with the expiration of the term of the lease. The $100,000. value assigned to the improvements was arrived at by dividing the $200,000. appraised value equally between land and improvements.

The respondent disallowed these deductions for depreciation, thereby increasing the net income distributed and distributable to petitioner from the trust estate by $1,666.67 for the year 1953 and $5,000. for each of the years 1954 and 1955, and determined deficiencies in petitioner's income tax for the years 1953, 1954 and 1955 in the respective amounts of $672.63, $2,938.13 and $2,782.92.

The notice of deficiencies was mailed to petitioner on August 30, 1957, and on November 20, 1957, the petitioner filed her petition with the Tax Court for a redetermination of the deficiencies. The jurisdiction of the Tax Court, the court of first instance, was conferred by 26 U.S.C. Sections 6213, 6214 and 7442.

In the proceeding before the Tax Court the petitioner established the foregoing facts and also that as of August 31, 1953, the date of Mrs. Millhiser's death:

(1) The fair market value of the land free of the lease and the improvements was $154,000;

(2) The fair rental value of the land was $7,700. net annually, and the commuted value as of that date of petitioner's right to receive to the termination of the lease on January 31, 1973 the rentals in excess of the then fair rental value was $38,685;

(3) The excess over the then fair rental (premium rental) arose from (a) the fact that by leasing the property along with adjacent properties, it acquired a "corner influence" and overcame the handicap of a narrow frontage and depth, and (b) the fact that by 1953 this downtown area was starting to feel the effects of suburban development;

(4) The useful physical life of the building is 50 years from the date of its construction, assuming that the G. C. Murphy Company or another common tenant would continue to occupy the whole building; and

(5) In event neither the G. C. Murphy Company nor any other common tenant would occupy the entire

building so that the same would be divided into the component ownerships, the useful life of the portion upon 409 East Broad Street would extend beyond January 31, 1973, the termination of the lease, but would be less than 50 years.

Petitioner's position was and is that her inherited property was depreciating by lapse of time and that accordingly under Section 167 of the Internal Revenue Code of 1954 (and Section 23(l) of the Internal Revenue Code of 1939 for petitioner's taxable year 1953) she is entitled as a depreciation deduction from rental income to a reasonable allowance for exhaustion, wear and tear and obsolescence measured by either (1) depreciation of the physical improvements or (2) amortization of the commuted value of the favorable lease.

The Tax Court, two judges dissenting, rejected petitioner's contentions and upheld the deficiencies determined by the respondent. Upon petition to review the decision of the Tax Court, the United States Court of Appeals for the Fourth Circuit affirmed the decision of the Tax Court by the judgment hereby sought to be reviewed.

REASONS RELIED ON FOR GRANTING THE WRIT

I

The Decision of the Fourth Circuit Conflicts With an Applicable Principle Decided by the Second Circuit and Impliedly Approved in the Opinion of This Court affirming Other Issues in That Case

With respect to the first issue in this case, that is whether petitioner is entitled to a deduction measured by depreciation of physical improvements, the decision of the Fourth Circuit appears in accord with decisions of the Second, Fifth, Seventh, Eighth and Ninth Circuits[2] but at the same time in conflict with the decision of the Second Circuit and with the opinion of this Court in the case of *Millinery Center Building Corporation* v. *Commissioner*, 350 U.S. 456 (1956), affirming 221 F.2d 322 (1955).

The Fourth Circuit in following the other circuits bottomed its opinion upon the premise that although the petitioner had acquired a "basis" for depreciation allowances under the applicable provisions of the Internal Revenue Codes, "the burden is upon the taxpayer to prove that she has a depreciable interest in that building, which she has failed to do. All she could acquire by inheritance from her mother, the testatrix, was such interest as her mother had to devise." (App. 11 and 12).

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[2] *Goelet* v. *United States*, 266 F.2d 881 (2d Cir. 1959) *affirming per curiam*, 161 F. Supp. 305 (1958); *Commissioner* v. *Pearson*, 188 F.2d 72 (5th Cir. 1951), *cert. denied*, 342 U.S. 861 (1951); *Friend* v. *Commissioner*, 119 F.2d 959 (7th Cir. 1941), *cert. denied*, 314 U.S. 673 (1941); *First National Bank of Kansas City* v. *Nee*, 190 F.2d 61 (8th Cir. 1951); *Commissioner* v. *Moore*, 207 F.2d 265 (9th Cir. 1953), *cert. denied*, 347 U.S. 942 (1954).

In the *Millinery Center* case, *supra*, the tenant had constructed a building upon leased property and had deducted the entire cost of the building in annual depreciation allowances over the original term of the lease. Thereafter during a renewal term the tenant purchased the property from the landlord for a price very substantially in excess of the value of the land. The Tax Court held that the tenant (1) could not deduct the excess as an ordinary and necessary business expense; (2) could not amortize the excess over the remaining term of the lease; and (3) could not take annual depreciation because the cost of the building had already been fully depreciated. The Second Circuit affirmed the Tax Court on points (1) and (2) but allowed annual depreciation deductions for the excess over the remaining life of the building.

This Court granted certiorari limited to questions involving points (1) and (2) and upon these affirmed the Second Circuit. Mr. Justice Frankfurter, writing for the Court, said:

> "What petitioner acquired in this transaction, however, were both rights with respect to the land and rights with respect to the building. The Tax Court has not yet fixed that amount of the purchase price which is allocable to the acquisition of rights in the land and that which is allocable to the acquisition of rights in the building. These rights are assets with useful lives having no reference to the term of the lease. Successive steps of securing or renewing a lease and then purchasing the reversion should not result in amortization over the term of the lease when the purchase of the whole fee at one time would result in depreciation over the useful life of the asset, if the asset acquired were a wasting asset.

> "Petitioner has acquired two assets—land and a building—whose use it will have for the remainder of their useful lives . . . " (350 U.S. 460)

The principal if not the only difference between the *Millinery Center* case and instant one is that in the former the taxpayer acquired a new basis in the building by purchase from the landlord and in the instant case by death of the landlord. The Millinery Center Building Corporation purchased the identical interests in the land and building subject to lease that petitioner here took by devise; the lease was extinguished in the earlier case only because the purchaser happened also to be the tenant. There would appear to be no valid distinction in the fact that the purchase extinguished the lease while the devise did not, for otherwise the right to depreciate improved property upon acquisition would turn solely on whether it were subject to a lease or free of a lease at the time of acquisition.

It seems well settled that whether a successor in title has a right to depreciation in no wise depends upon whether the predecessor in title had one at the time of transfer. This is not only held in the *Millinery Center* case but is daily exemplified by instances in which the predecessor has fully depreciated a wasting asset.

II

The Decision of the Fourth Circuit Conflicts with the Decision of the Ninth Circuit on the Same Matter

The second issue in this case is whether the petitioner is entitled to a depreciation allowance measured by amor-

tization of the premium value of the lease on 409 East Broad Street. The decisions of the Fourth Circuit in the instant case and of the Seventh Circuit in *Friend* v. *Commissioner*,[3] are directly in conflict with the decision of the Ninth Circuit in *Commissioner* v. *Moore*.[4] This conflict was conceded by both the Tax Court and the Fourth Circuit in the instant case, and the conflict between the Seventh and Ninth Circuits was noted by the Court in the *Moore* case.

Indicating the necessity for settlement by this Court of the disputed question here involved, Judge Boreman writing for the Court below noted the conflict with the decision of the Ninth Circuit in the *Moore* case as follows:

> "Thus we find decisions of two circuits, one in the apparent irreconcilable conflict with the other on this question, although in agreement in denying the taxpayer's right to claim depreciation of the lessee constructed building. The problem created by this conflict between circuits has not been illuminated by the failure of the Supreme Court to grant certiorari in the two cases, namely *Friend* v. *Commissioner*, *supra*, and *Commissioner* v. *Moore*, *supra*. (App. 14)
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> * * *
>
> "Until Congress has acted to clear away the confusion arising from this divergence of views as to the meaning, effect and application of the depreciation statutes, or until these questions have been resolved by the highest judicial authority, we can adopt only

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[3] 119 F.2d 959 (1941), *cert. denied*, 314 U.S. 673 (1941).
[4] 207 F.2d 265 (1953), *cert. denied*, 347 U.S. 942 (1954).

that which appears to us to be the sounder view, realizing that disagreement with the decision of either the Seventh Circuit or the Ninth Circuit is thus inescapable." (App. 20)

Both the *Friend* case and the *Moore* case also involved real estate subject to lease upon which the tenant at its own expense had constructed a building during the lifetime of the owner. In each case, as in the instant case, it was established that at the death of the owner the rental yield of the lease was in excess of the then fair rental value of the land alone, and in both cases the taxpayers who had acquired the land upon the death of the owner[5] claimed the right to a depreciation allowance for the value of this excess over the remaining term of the lease.

In the *Friend* case this right was denied, apparently on the ground that the taxpayers under the applicable Revenue Act were not in the position of a purchaser of the leasehold for a valuable consideration, that is that they had no basis for depreciation.

In the *Moore* case this right was recognized and allowed on the ground that the taxpayer under applicable Internal Revenue Code provisions substantially identical with those in the *Friend* case, was "in the same position as if he were a purchaser," that is that he had a basis for depreciation.

In the instant case the Fourth Circuit while noting the irreconcilable conflict between the Seventh and Ninth Circuits, appears to recognize that petitioner has a basis for depreciation but distinguishes her case from the *Moore*

[5] The executors in the *Friend* case, the devisee in the *Moore* case.

case on the ground that in the *Moore* case the term of the lease extended beyond the useful life of the building while in the instant case the building may have value after the term. But this can have reference only to th *quantum* of depreciation not to the *right* of depreciation. Any value in the reversion would be the equivalent of "salvage value" in determining allowances for depreciation of physical assets.

III

The Decision of the Fourth Circuit Involves a Question of Federal Law Which Has Not Been, But Should Be, Settled By This Court

The questions presented in this case are important in the administration of the Federal tax laws and settlement of them by this Court is plainly in the public interest for they have been and otherwise will be presented in numerous cases and in various forms.

It has been the policy of the Congress since the first income tax law, the Revenue Act of 1913, to recognize the right of the taxpayer to have his capital in a wasting asset maintained intact through reasonable allowances for its exhaustion, wear and tear. The right to depreciation allowances is not only of the utmost importance to the owner of property but it is of equal importance to every prospective purchaser and has a powerful impact upon its market value.

In the line of cases of which that at bar is one, it has been decided in five circuits that when a tenant has constructed improvements upon property subject to lease, the heir or devisee of the landlord is not entitled to an allowance

for depreciation measured by the life of those improvements although he has acquired a basis for depreciation under the tax laws.[6]

Such depreciation has been disallowed in the case of a purchaser both by the Second Circuit[7] prior to the instant case and by the Tax Court subsequent to and relying upon the Tax Court decision in the instant case.[8]

In the earlier cases emphasis was placed on the fact that the useful life of the improvements would end before the termination of the lease, but this fact has been declared immaterial in the *Goelet* v. *United States*[9] case and in the case at bar.

In the *Moore* case, *supra*, although an allowance based on the physical improvements was denied, an allowance based on the exhaustion of a favorable leasehold was upheld. But this also was denied in the *Friend* case, *supra*, and in the instant case.

Leases obligating or permitting the tenant to construct improvements are common in the United States, and the descent, devise and sale of such properties are also common.

If the Circuit Courts are right there is therefore an exceedingly large class of properties upon which deprecia-

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[6] Cases cited note 2, *supra*. In the *Friend* case the existence of this basis was denied, although this seems clearly wrong.

[7] *Bernstein* v. *Commissioner*, 230 F.2d 603 (1956), *affirming per curiam*, 22 T.C. 1146 (1954).

[8] *World Publishing Company* v. *Commissioner*, 35 T.C. ..... No. 2 (1960).

[9] 266 F.2d 881 (2d Cir. 1959).

tion of the improvements will not be allowed to a successor in title simply upon the ground that the predecessor in title had no right of depreciation.

This conclusion has been based on the premise that the heir, devisee or purchaser has not acquired a wasting asset! Yet he has acquired the identical legal rights, title and interest in the land, improvements and lease which he would have acquired had those improvements been constructed by the prior owner instead of by the tenant of the prior owner.

How can it be said that land and buildings subject to lease is not a wasting asset in the hands of a devisee or purchaser if the tenant constructed the improvements, but is a wasting asset if the lessor did so? If this reasoning is carried to its inescapable conclusion, depreciation would be denied to the heir, devisee or purchaser of all leased property.

The present state of the law gives rise to the following unresolved questions:

1. Where the tenant of the prior owner has constructed the improvements is the heir or devisee of the prior owner entitled to depreciation if the lease expires one day before the death of the prior owner? One day after? Is the length of lease of any consequence?

2. Where the tenant of the prior owner constructed the improvements subject to lease at the date of death is the property passing to the heir or devisee not a wasting asset but is one if those improvements were constructed by the prior owner?

3. Is the purchaser of tenant-constructed improvements in different case from an heir or devisee because his basis arose from cost instead of from death value, despite the fact that the Internal Revenue Codes make no distinction as to how the basis was acquired?

The answers to all of these questions vitally affect the economics of real estate ownership throughout the United States. It is submitted that these are not moot questions but implicit in the facts presented in the instant case.

Manifestly the right of depreciation is a prime consideration to any purchaser. If in the instant case the petitioner has no such right because her ancestor had none, does it not follow that a purchaser from her will have none, because she has none? And if this may be so is not the public entitled to know by the pronouncement of this Court that the market values of all improved properties throughout the nation are affected by the question whether the improvements thereon were constructed by owner or tenant?

The basic question presented here is whether as to this property and under these facts "there shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)." Whether this "reasonable allowance" should be determined by exhaustion of physical improvements or of a favorable leasehold is in the final analysis a question only of the measure of the deduction, not the right to the deduction.

It would appear of eminent public interest that this Court determine upon the facts here presented whether or not this right exists.

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

LeRoy R. Cohen, Jr.
John F. Kelly

1003 Insurance Bldg.
Richmond 19, Virginia

Counsel for petitioner

APPENDIX

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 8164.

ROSALIE M. SCHUBERT,
Petitioner,

versus

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ON PETITION TO REVIEW THE DECISION OF THE TAX COURT OF THE UNITED STATES.

(Argued October 10, 1960. Decided January 17, 1961.)

Before SOBELOFF, Chief Judge, BOREMAN, Circuit Judge, and STANLEY, District Judge.

LeRoy R. Cohen, Jr., (John F. Kelly on brief) for Petitioner, and Fred E. Youngman, Attorney, Department of Justice, (Charles K. Rice, Assistant Attorney General, Lee A. Jackson and A. F. Prescott, Attorneys, Department of Justice, on brief) for Respondent.

APPENDIX

BOREMAN, Circuit Judge:

This case is here on petition to review the decision of the Tax Court of the United States which affirmed the determination by the Commissioner of Internal Revenue of deficiencies in federal income taxes of the Petitioner. The facts hereinafter stated were stipulated and accordingly found by the Tax Court. Petitioner will be referred to as taxpayer.

Taxpayer's mother, Gazelle K. Millhiser, hereinafter sometimes referred to as testatrix or lessor, owned real estate in Richmond, Virginia, described as 409 East Broad Street, located about sixty-one feet from the intersection of Broad and Fourth Streets, having a frontage of 19.04 feet and extending 138 feet to an alley in the rear. On October 2, 1941, testatrix leased this property to G. C. Murphy Company, hereinafter called Murphy. At about the same time Murphy entered into two other leases with the owners of adjacent properties, each of the three leases being for a term ending January 31, 1973. Murphy was authorized to demolish the building on each of the three properties, use or sell the salvage materials and construct one building on the three parcels in accordance with certain plans and specifications.

The Millhiser lease began November 1, 1944, and provided for rentals thereafter of $1,000 per month through January 1948, $1,145.83-1/3 per month thereafter through January 1958, and $1,208.33-1/3 per month thereafter through January 1973. Some of the other provisions of the lease may be summarized as follows:

(a) Murphy was obligated to reimburse lessor for all real estate taxes and charges against the property during

the term in excess of $2,445.91 annually and for the cost of fire insurance on the improvements during the term in excess of $184.09 annually.

(b) Murphy agreed to surrender and deliver to lessor, at the end of the term, any new building which might be erected on the property, unencumbered by it, and in as good order, repair and condition as when completed, ordinary wear and tear and accidents by fire or other casualty excepted.

(c) Murphy agreed, at the end of the term, to erect individual walls along the boundary lines of the property, to restore separate water, sewer and power lines and other facilities so as to make the building upon the demised premises a separate rentable unit.

(d) Murphy was to make all exterior and interior repairs during the term.

On or about May 1, 1947, demolition of existing improvements was begun by Murphy and was immediately followed by the construction of one department store building on all of the several demised properties. This building, consisting of a basement and five stories, was completed about July 1, 1948, at a total cost of $1,442,969 and had an estimated useful life of fifty years from July 1, 1948.

The estimated cost of that part of the building constructed on the property of testatrix was from $150,000 to $180,000 and was borne by Murphy, except to the extent of salvage value recovered by Murphy from the demolished building.

The cost to testatrix of the old improvements upon her property at the time of demolition on May 1, 1947, after depreciation was $6,200. For income tax purposes she claimed on account of depreciation of the demolished improvements a deduction at the rate of $240.77 annually from May 1, 1947, until her death.

Testatrix died on August 31, 1953, and, by her will, nominated her son, hereinafter called "trustee," as executor thereof and as trustee of the residual estate. Pursuant to the authority conferred by the will, trustee allocated the property at 409 East Broad Street to the residual estate devised to the taxpayer in trust for life. A federal estate tax was paid on this property at an appraised value of $200,000.

The trustee paid to taxpayer the annual income as computed by him since August 31, 1953, and, as her attorney-in-fact, filed income tax returns for her for the years in question. These returns report as income the net rents from 409 East Broad Street, computed by the trustee, as follows:

	1953	1954	1955
Gross rents	$4,583.32	$17,422.61	$17,422.31
Less:			
Real Estate Taxes		6,118.56	6,118.22
Insurance	7.54	12.32	93.59
Commissions	275.00	825.00	825.00
Depreciation	1,666.67	5,000.00	5,000.00
Net rents	$2,634.11	$ 5,466.73	$ 5,385.50

(Note: We are not concerned here with the deductions for real estate taxes for the years 1954 and 1955.)

The Commissioner disallowed the deductions for depreciation as shown above for the years in question, thereby increasing the net income distributable to taxpayer from the trust estate. It is this adjustment which alone gives rise to the asserted deficiency.

Taxpayer contends that she should be allowed a deduction for depreciation in each of her taxable years (adjusted for 1953 from the date of her mother's death to end of year):

(1) In an amount equal to the value of the improvements as of August 31, 1953, as determined for estate tax purposes, divided by the number of years of then remaining useful life; or

(2) In the alternative, in an amount equal to the commuted or capitalized value at the date of her mother's death of the right to receive favorable premium rentals, divided by the number of years remaining of the term of the lease. (Testimony was presented to show that such commuted or capitalized value at August 31, 1953, was not less than $38,685 and that the lease then had 19-5/12 years to run.)

The Tax Court rejected both contentions and upheld the Commissioner.[1] We find no error.

The statutes asserted by taxpayer as applicable here in support of her claims to an allowance for depreciation are set forth below.[2]

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[1] 33 T. C. 1048 (1960).

[2] Following are the asserted applicable sections of the Internal Revenue Code of 1954, but the corresponding sections of the Code of 1939 and prior revenue acts were not substantially different. (All references are to Title 26 U. S. C.).

Section 167(a), (Sec. 23(*l*), 1939 Code):

APPENDIX

It is taxpayer's first theory that she acquired a basis for depreciation purposes upon the death of testatrix; that it is not the estate tax which gives rise to a "basis" in the heir but rather the then fair market value of the asset upon which the tax is paid; that of the $200,000, which was the appraised value of the land and improvements for estate tax purposes, approximately one-half, or $100,000, was the

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"There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business, or

(2) of property held for the production of income."

Section 167(f), (Sec. 114, 1939 Code):

"The basis on which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 1011 for the purpose of determining the gain on the sale or other disposition of such property."

Section 167(g), (Sec. 23(l), 1939 Code). The 1939 Code is silent with respect to estates, but the same principle was recognized and applied:

"In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant. In the case of property held in trust, the allowable deduction shall be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each. In the case of an estate, the allowable deduction shall be apportioned between the estate and the heirs, legatees, and devisees on the basis of the income of the estate allocable to each."

Section 1011, (Sec. 23(n), 1939 Code):

"The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis (determined under section 1012 or other applicable sections of this subchapter * * *), adjusted as provided in section 1016."

Section 1014(a) (the applicable section of the subchapter) (Sec. 113(a)(5), 1939 Code):

"* * * the basis of property in the hands of a person acquiring the property from a decedent or to whom the property passed from a decedent shall * * * be the fair market value of the property at the date of the decedent's death * * *"

Section 1014(b), (Sec. 113 (a) (5), 1939 Code):

"For the purposes of subsection (a), the following property shall be considered to have been acquired from or to have passed from the decedent:

"(1) Property acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent; * * *".

value of the Murphy-constructed building on the land; that when a taxpayer has a "basis" in an income-producing asset which diminishes in value by lapse of time through wear, tear, obsolescence or exhaustion, such taxpayer is entitled by *statutory right* to recover that basis by a reasonable allowance for depreciation over the remaining period of useful life; that it is simple justice to permit deductions from income sufficient to restore wasting principal; that section 167 of the 1954 Code and section 23 of the 1939 Code, allowing depreciation, refer to "property" which may be a physical building or a favorable leasehold; and, if it is once established that taxpayer has a basis in a wasting asset, the sole remaining problem is the appropriate measure to be applied.

An early line of Tax Court decisions supported the theory that the prescription of a "basis" in and of itself would permit the allowance of a deduction for depreciation. In the first such case involving depreciation of inherited leased improvements constructed by the ancestor's lessee under a long term lease, Charles Bertram Currier, 7 T. C. 980 (1946), it was held at page 984:

> "The basis of inherited property is accordingly not cost * * * and to say that a property cost the taxpayer nothing makes no contribution to the solution of the present question. As opposed to cost, the basis of property acquired by devise is categorically fixed by statute as fair market value on the date of acquisition. Internal Revenue Code, sec. 113 (a) (5) [now § 1014(a)]. Hence, if we can discover the fair market value of the property in question at the date of decedent's death, Augustus v. Commissioner (C. C. A., 6th Cir.), 118 Fed. (2d) 88, (or the figure at which it was returned

for estate tax purposes, which is recognized as the equivalent, Regulations 103, sec. 19.113 (a) (5)) the upshot would ordinarily be its basis for depreciation in petitioner's hands, without any reference to its 'cost'. Having acquired a basis by the incidence of the estate tax, the gradually disappearing value of a wasting asset can not be replaced except by periodic depreciation adjustments."

Two subsequent Tax Court decisions involving parallel fact situations approved and followed the Currier decision and adopted the language as above quoted. J. Charles Pearson, 13 T. C. 851 (1949); Mary Young Moore, 15 T. C. 906 (1950). Each of these subsequent approvals of the Currier decision was reversed on appeal. Commissioner v. Pearson, 188 F. 2d 72 (5th Cir. 1951), cert. den. 342 U. S. 861 (1951); Commissioner v. Moore, 207 F. 2d 265 (9th Cir. 1953), cert. den. 347 U. S. 942 (1954). In reversing the Moore decision, the Ninth Circuit clearly dispelled the notion that "basis" alone would permit depreciation, stating:

"The Tax Court properly noted that section 113 (a) (5) [now § 1014(a)] would operate to supply, for an inherited * * * interest, a 'basis' which had theretofore not existed * * * [b]ut a 'basis' is only one of the factors which must exist before depreciation may be claimed. More important is the necessity of a 'depreciable interest' in exhausting and deteriorating property. If the taxpayer's interest is of such character that it is not affected by the deterioration, then it is not of a depreciable nature. That the provision defining basis is by itself insufficient to authorize the deduction was well stated by the Court of Appeals for

the Eighth Circuit in First National Bank of Kansas City v. Nee, 190 F. 2d 61, 64, as follows: 'It must at once be obvious that unless an item of property in respect of which depreciation has been claimed is properly within the reach of the * * * statute, those further provisions of the law are quite irrelevant which serve merely to define the basis upon which depreciation, validly asserted, is to be computed. The prescription of a depreciation basis presupposes, but does not amplify, depreciability.'

"* * * Sec. 113 (a) (5), while providing a 'basis', does not create a depreciable interest where none would otherwise exist." 207 F. 2d at 269.

Cf. Helvering v. Bruun, 309 U. S. 461 (1940); M. E. Blatt Co. v. United States, 305 U. S. 267 (1938). The decision of the Tax Court in the instant case disallowing the taxpayer's claim for depreciation of the building for each of the years here in issue is further supported by the following cases: Friend v. Commissioner, 119 F. 2d 959 (7th Cir. 1941), cert. den. 314 U. S. 673 (1941); First Nat. Bank of Kansas City v. Nee, 190 F. 2d 61 (8th Cir. 1951); Goelet v. United States, 266 F. 2d 881 (2d Cir. 1959), affirming per curiam, 161 F. Supp. 305 (S. D. N. Y. 1958).

The cases hereinbefore cited, namely, Friend v. Commissioner, Commissioner v. Pearson, First Nat. Bank of Kansas City v. Nee, and Commissioner v. Moore, differ from the instant case only in the fact that in each of those cases the estimated useful life of the tenant-constructed building, for depreciation purposes, expired prior to the expiration date of the lease on the premises at date of death, while here the estimated useful economic life of the

building extends beyond the expiration date of the lease. However, Goelet v. United States, supra, is not even subject to this distinction and the courts which considered the case found this difference in fact to be without legal significance.

In Albert L. Rowan v. Commissioner, 22 T. C. 865 (1954), decided after the reversal of the Tax Court in the Pearson and Moore cases, that court re-examined its position, concluded that the Fifth Circuit in Commissioner v. Pearson, supra, and the Ninth Circuit in Commissioner v. Moore, supra, stated the correct rule of law, and specifically overruled its prior decisions in the Currier, Pearson and Moore cases. In the Rowan case, which involved a lessee-constructed building and the claim of taxpayer to depreciation, the Tax Court disallowed depreciation and held:

> "She [taxpayer-petitioner] was receiving no rental from the building; she had no investment in the building. Ground rental was all that the heirs of Ellen Rowan, including petitioner, received from the property. During the taxable years they were not receiving any rental income from the building itself. The rental income from the building was being received by the lessee who had erected the building on the leased land at his own expense. The lessee was the one to whom annual depreciation deductions on the cost of the building were properly granted." (22 T. C. 874.)

The principles underlying depreciation allowances are too well settled to merit extended discussion here. For present purposes, we hold that the applicable statute[3] limits the depreciation deduction to (1) property used in the trade or business of the taxpayer, or (2) property held by the tax-

[3] Section 23(*l*) of the 1939 Code; Section 167(a) of the 1954 Code.

payer for the production of income.[4] Thus, before any deduction for depreciation can be allowed, the taxpayer must first establish that she has an interest in "property" with respect to which the allowance of depreciation is authorized by the statute. Unless the property claimed to be depreciable is properly within the reach of the applicable statute, that is, *property used in the trade or business of the taxpayer, or property held by the taxpayer for the production of income*; the further provisions of the law are quite irrelevant which serve merely to define the basis upon which the depreciation, validly asserted, is to be computed. First Nat. Bank of Kansas City v. Nee, 190 F. 2d 61 (8th Cir. 1951).

The taxpayer's contention that she is entitled to depreciation deductions with respect to the Murphy-constructed building is predicated solely upon the erroneous proposition that she (or rather the trust estate) acquired a new *basis* in the property in issue by reason of the devise from her mother, the testatrix. As made abundantly clear by the above cited and other decisions, the statutory provisions prescribing the "basis" for computing depreciation do not also create depreciability. "Depreciation allowances are limited to depreciable property and exclude assets not of that character." Friend v. Commissioner, 119 F. 2d 959, 960 (7th Cir. 1941). Accordingly, in order to sustain her claim to depreciation allowance on the Murphy-constructed building here involved, the burden is upon the taxpayer to prove that she has a depreciable interest in that building, which she has failed to do. All she could acquire

[4] Other sections of the statutes, notably Sections 23(n) and 114(a) of the 1939 Code, and Section 167 (f) of the 1954 Code, prescribe the so-called "basis" upon which such allowance shall be computed, and the *amount* of the allowance for any given year is determined by other factors, such as useful life, pertaining to the particular property in issue.

by inheritance from her mother, the testatrix, was such interest as her mother had to devise. At the time of her death, the testatrix owned in fee the improved Broad Street real property subject to a long term lease. As such owner, the testatrix did not acquire any interest, taxwise, in the Murphy-constructed building upon its completion. M. E. Blatt Co. v. United States, 305 U. S. 267 (1938). She had only the right to recover the loss of an existing improvement which was demolished to make way for the new building. The taxpayer's interest in the Murphy-constructed building could come into existence, taxwise, only upon termination of the lease, at which time she could claim title and possession. Helvering v. Bruun, 309 U. S. 461 (1940).

Indeed, all this taxpayer, or the trust estate, acquired under the will of the testatrix was a life estate in improved real property subject to a long term lease, plus an unencumbered life estate in the property, including the Murphy-constructed building, at the expiration (or earlier termination) of the lease if she should survive such termination.[5] Taxpayer's income is derived solely from the ground rentals. Income which is the product of the use of the structure inures to the benefit of the lessee, Murphy, the entity which is truly holding the building for the production of that income. Taxpayer does not hold the wasting property for the production of income and is, therefore, not entitled to the statutory exclusion. First Nat. Bank of Kansas City v. Nee, 190 F. 2d 61 (8th Cir. 1951).

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[5] While taxpayer had only a life estate under the trust provisions of her mother's will, by the terms of section 167(g) any proper depreciation deduction would be computed and allowed as though the life tenant were the absolute owner.

PREMIUM RENTALS

If the claimed right to depreciate the building should be denied, in the alternative taxpayer theorizes: That, at the date of death of testatrix, the rental provided by the lease was higher than the then fair rental value of the land, the valuation of the property was higher than the value of the land subject to normal rentals, and thus taxpayer acquired a basis in a favorable leasehold which will end with the lease; that, to the extent of these excess or premium rentals, she has acquired, and is holding, as capital or principal, for the production of income, an asset wasting by lapse of time since, upon and after the termination of the lease, the land will yield only its lesser fair rental value; that at that time the premium rentals will have been exhausted and will vanish.

It appears that only two courts, other than the Tax Court, have considered and passed upon the question raised by taxpayer's alternative claim. In Milton H. Friend, et al., Trustees, 40 B. T. A. 768, the same argument as here advanced by taxpayer was rejected. The Court of Appeals for the Seventh Circuit affirmed. Friend v. Commissioner, 119 F. 2d 959 (1941). There the executors of a decedent lessor, who had demised premises to tenants who erected buildings thereon, contended that the excess valuation placed upon the leases over what would have been a reasonable rental value of the land itself, was an exhaustible asset on which they were entitled to depreciation, amortization or exhaustion for income tax purposes. The taxpayers asserted that they had acquired a basis for amortization by virtue of section 113 (a) (5) of the Revenue Code of 1939 (now § 1014(a)). At 119 F. 2d 961, the Court said:

"It is plain from a reading of the statute that what is meant is to give the asset, whatever it may be, a basis for valuation for the purpose of determining gain or loss for income tax purposes in the event of a future sale of the asset. The statute cannot be construed, even in conjunction with the valuation for estate tax purposes and the payment of that tax, to place the petitioners in the position of a purchaser of the leaseholds for a valuable consideration. Therefore, the contention of the petitioners must fail, and their other contentions must fall with it."

In Mary Young Moore, 15 T. C. 906 (1950), the Tax Court, under facts sufficiently similar to those in Friend v. Commissioner, supra, to raise the question of taxpayer's right to capitalize and claim deduction for premium lease rentals, again refused to allow the deduction. However, on appeal to the Ninth Circuit, Commissioner v. Moore, 207 F. 2d 265 (1953), that court disagreed not only with the Tax Court's decision on this point but also noted its disagreement with the decision and opinion of the Seventh Circuit in Friend v. Commissioner, supra.

Thus we find decisions of two Circuits, one in apparent irreconcilable conflict with the other on this question, although in agreement in denying the taxpayer's right to claim depreciation of the lessee-constructed building. The problem created by this conflict between Circuits has not been illuminated by the failure of the Supreme Court to grant certiorari in the two cases, namely, Friend v. Commissioner, supra, and Commissioner v. Moore, supra.

As noted by the Tax Court in its opinion in the instant case, the Ninth Circuit in Commissioner v. Moore, supra,

apparently held that there is no difference between a transfer by death or purchase; that the devisee of land is to be considered a purchaser of the lease paying a bonus or premium for the acquisition of the *favorable features* of the lease, which he should be allowed to recover as his "investment" in the property by depreciating a portion of the rents he will receive over the remaining period of the lease. At 207 F. 2d page 277, the Court said:

> "What we are here considering, as a possible item of property for depreciation, is not the lease, as such, but rather *the favorable aspects or part of the lease.*" (Emphasis supplied.)

But in Commissioner v. Moore, supra, we find that the lease there involved was for a term of ninety-nine years, a period much greater than the estimated useful life of the building constructed by the lessee. Thus no significance could be attached to the right of reversion. At the termination of that lease, the right to claim possession and control of a building, the useful life of which had been fully exhausted, would have no real value. Theoretically, such a building could then be a burden rather than a valuable asset. In the instant case, the Murphy-constructed building will have a remaining period of useful life following the termination of the lease and thus the right to claim ownership, possession and control of the building is a valuable right.

At the trial before the Tax Court, taxpayer adduced testimony to the effect that the combining of the three separate properties into one unit gave the single structure "corner influence," thus overcoming the handicap of the narrow frontage of the 409 East Broad Street property; that although, as leased with other properties, the building had an estimated useful economic life of fifty years, it

would, at the end of the lease term if not occupied with other properties by a common tenant, revert to taxpayer as a separate narrow structure, its practical use for the remainder of its useful shortened economic life being thus substantially restricted and diminished. Further evidence was presented to show that, although the assessed value of this property for local taxes in 1953 was $272,640, approximately equally apportioned between the land and the improvement, the value of the land free of the lease would have been $154,000 with a fair net annual rental of $7,700; that the excess portion of the actual net annual lease rental over the sum of $7,700 was, in fact, a "premium" rental attributable to the lease and the building constructed pursuant to lease terms.

Taxpayer offered the expert testimony of a witness who, no doubt, was well qualified as an appraiser of real property and experienced in rental operations and values in the vicinity of the property here involved. He gave as his opinion that, at the termination of the lease, the income producing value of the building would be less than the rental value created by the Murphy lease. But he admitted that his testimony was highly speculative. In giving his opinion he was obviously assuming as a fact that, at the termination of the lease, the building would be returned and surrendered as a single and separate unit having no connection with the other properties included in the lease.

When the Murphy lease expires in 1973, there are several possibilities but they cannot be determined by gazing into a crystal ball. In Goelet v. United States, 161 F. Supp. 305, 309, the Court said:

"It is well established that 'Federal income taxes are based on reality not form, on fact not fancy, on substance not seeming. See Bowers v. Kerbaugh-Empire Co., 271 U. S. 170, 46 S. Ct. 449, 70 L. Ed. 886; Irwin v. Gavit, 268 U. S. 161, 166, 45 S. Ct. 475, 69 L. Ed. 897; Roberts v. Commissioner of Internal Revenue, 9 Cir., 176 F. 2d 221, 225 [10 A. L. R. 2d 186].' United States v. Maryland Jockey Club, 4 Cir., 1954, 210 F. 2d 367, 371. See also, Weiss v. Stern, 1923, 265 U. S. 242, 44 S. Ct. 490, 68 L. Ed. 1001; United States v. Phellis, 1921, 257 U. S. 156, 42 S. Ct. 63, 66 L. Ed. 180."

By the same reasoning, the application of tax deduction statutes should not be based on one of several possible assumptions of fact or on mere speculation and conjecture. The Murphy building is constructed on three leased properties subject to the condition that, at the time of return to the owners, it must be remodeled and surrendered as separate rental units, and, *if* strict compliance with the condition is had, it *might* then develop that the income producing value of each unit would be lessened. But it is only reasonable to suppose that the owners of the three separate parcels of land will make every possible effort to utilize the building, for its remaining life, in its most productive form and re-lease to Murphy or lease to another common tenant on terms no less favorable than those of the existing lease. In either event the new terms, conditions and rentals would be matters of negotiation and would doubtless be determined by conditions then existing including demand, desirability of location, business trends and other factors which could not now be reliably forecast; further, it might be very advantageous to Murphy, if not then interested in re-leasing, to pay to each owner a substantial sum in order

to be relieved of the great expense of structural changes and restoration of facilities necessarily involved in dividing the one building into three separate rental units. It is quite conceivable and very probable that, as the termination date of the lease approaches, bringing with it the right of reversion, the taxpayer's interest may be increasing in value rather than wasting by the passage of time.

What we have here said is simply to point up a very cogent consideration weighing against the allowance of amortization of premium rentals, that is, the highly speculative nature of the testimony and the hypothetical assumption that the property may revert in less valuable form. In Commissioner v. Moore, supra, the Ninth Circuit recognized the necessity of a wasting of the asset before the allowance of amortization. At 207 F. 2d, page 277, that Court said:

> "Again the intangible property which we here consider must be found to be subject to ultimate exhaustion, if depreciation or amortization is to be allowed. * * * If the terms of the lease are such that it could be renewed at any time on the same terms, there will be no exhaustion, or wasting, or wear and tear, and no occasion for depreciation or amortization."

While it is the well settled rule that any doubt or uncertainty as to the application of a statute providing for a tax on income must be resolved in favor of the taxpayer, a different rule prevails where the taxpayer seeks to exempt income from taxation. Deductions from gross income are a matter of grace and a taxpayer seeking a deduction must be able to point to an applicable statute and show that he comes within its terms. Mays v. Bowers, 201 F. 2d 401,

402 (4th Cir. 1953). The burden is squarely upon the taxpayer to bring himself clearly within the statutory provisions authorizing the claimed deduction or exemption. Belser v. Commissioner, 174 F. 2d 386, 389 (4th Cir. 1949).[6]

We do not hold or intimate that the depreciation statutes here involved are, in themselves, ambiguous. Clearly, the fair market value at the time of the death of testatrix was fixed by the statutes as the basis in the heir or taxpayer determinative of the gain or loss in the event of sale and the basis upon which depreciation, *if otherwise allowable*, may be calculated. The doubt arises as to the applicability of the deduction or depreciation statutes in the factual situation here presented. That such doubt exists is clearly demonstrated by the decisions of the Tax Court and the definitely conflicting decisions of the Seventh and Ninth Circuits.

The Tax Court, in the instant case, disregarded the testimony as to the premium values sought to be attributed to the favorable aspects of the lease and followed its own decision in Milton H. Friend, et al., Trustees, supra, and the Seventh Circuit in Friend v. Commissioner, supra. We have previously indicated our disagreement with the proposition that the prescription of a basis can have the effect of creating a depreciable asset or investment where none otherwise

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[6] Generally the allowance of deductions does not turn upon equitable considerations but depends on legislative grace. Deputy v. duPont, 308 U. S. 488, 493 (1940). The deduction must be "plainly authorized." Commissioner v. Swent, 155 F. 2d 513, 517 (4th Cir. 1946). The rule that ambiguities are to be resolved in favor of the taxpayer does not apply to statutes authorizing deductions. Helvering v. Insurance Co., 294 U. S. 686, 689 (1935). In case of doubt, a deduction statute is to be construed against the one claiming under it, notwithstanding the resolution of the doubt may work a disadvantage to the taxpayer. White v. United States, 305 U. S. 281 (1938).

exists. But, were we to accept taxpayer's theory that alleged excess or premium rentals should be treated as a separable, depreciable, intangible asset or investment, it is our opinion that the evidence fails to establish the claim of wasting or exhaustion thereof and, further, in the factual situation here, any testimony offered in support of such claim could be founded on nothing more than guess, speculation and conjecture.

Until Congress has acted to clear away the confusion arising from this divergence of views as to the meaning, effect and application of the depreciation statutes, or until these questions have been resolved by the highest judicial authority, we can adopt only that which appears to us to be the sounder view, realizing that disagreement with the decision of either the Seventh Circuit or the Ninth Circuit is thus inescapable.

Affirmed.

JUDGMENT

Filed and Entered January 17, 1961.
UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

No. 8164.

ROSALIE M. SCHUBERT,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ON PETITION to Review the Decision of the Tax Court of the United States.

THIS CAUSE came on to be heard on the record from the Tax Court of the United States, and was argued by counsel.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the decision of the said Tax Court of the United States, in this cause, be, and the same is hereby, affirmed.
January 17, 1961.

HERBERT S. BOREMAN
United States Circuit Judge.

APPENDIX

33 T. C. No. 118

TAX COURT OF THE UNITED STATES

[Caption Omitted]

Petitioner is a life beneficiary of a testamentary trust which includes in the corpus certain land which decedent had leased on a long-term lease. The tenant constructed one building on this and adjacent parcels of land. The estimated useful life of the building extended beyond the term of the lease. *Held*, petitioner is not entitled to a deduction for depreciation of the building; *held, further*, petitioner is not entitled to amortize the purported premium portion of the lease; and, *held, further*, section 275 (b), I.R.C. of 1939, is not applicable under the facts of this case to the year 1953.

Leroy B. Cohen, Esq. and John F. Kelly, Esq., for the petitioner.

Charles B. Norris, Esq. for the respondent.

MULRONEY, Judge: The respondent determined deficiencies in petitioner's income tax for the years 1953, 1954 and 1955 in the amounts of $672.63, $2,938.13 and $2,782.92, respectively.

Petitioner is the beneficiary of a testamentary trust and thus required to report trust income distributed or distributable to her, including rents from land decedent had

leased on a long-term lease, and on which the lessee had built a building. The questions are:

(1) Whether, in reporting such rents, petitioner is entitled to a deduction for depreciation during the years before the Court;

(2) Whether petitioner is entitled to amortize any premium value of the lease, and

(3) Whether any deficiency for the year 1953 is barred by section 275 (b), Internal Revenue Code of 1939.

FINDINGS OF FACT

Some of the facts have been stipulated and they are found accordingly.

Petitioner's mother, Gazelle K. Millhiser, owned certain real estate in the business section of Richmond, Virginia. On October 2, 1941, she leased this property, described as 409 East Broad Street, to G. C. Murphy Company. This property was located about 61.36 feet from the intersection of Broad and Fourth Streets and it consisted of a frontage on Broad Street of 19.04 feet with a depth of 138 feet to an alley in the rear. At about the time of the execution of the above lease, G. C. Murphy Company entered into two other leases with the owners of adjacent property extending to the corner of Fourth and Broad Streets and to the rear fronting on Fourth Street. The three leases were all for a term ending in each case on January 31, 1973 and they

permitted G. C. Murphy Company to demolish the buildings on the three properties, use or sell the salvage materials and put up one building on the three parcels in accordance with certain plans and specifications.

The leasehold period of the Millhiser lease began November 1, 1944[1] and it provided for monthly rental thereafter of $1,000 per month through January 1948, $1,145.83⅓ per month thereafter through January 1958 and $1,208.33⅓ per month thereafter through January 1973. Some of the other provisions of the lease may be summarized as follows:

(a) The tenant was obligated to reimburse the lessor for all real estate taxes and charges against the property during the term in excess of $2,445.91 annually, that being the amount of such taxes for the year 1940.

(b) The tenant was obligated to reimburse the lessor each year for the cost of fire insurance on the building and improvements during the term in excess of $184.09 annually, that being the amount of such premiums for the year 1940.

(c) The tenant agreed in case of a new building being erected on the property by the tenant it would deliver up the same at the end of the term in as good order, repair and condition as the same was in at the time of completion.

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[1] The three properties had existing leases on them in 1941, the longest of which expired in 1944.

ordinary wear and tear and accidents by fire or other casualty excepted.

(d) The tenant agreed at the end of the term to erect individual walls along the boundary lines of the property, to restore separate water, sewer and power lines and other facilities so as to make the building upon the demised premises a separate rentable unit.

(e) The tenant agreed that any building constructed by the tenant should be unencumbered by any act of the tenant and should be and become the property of the lessor upon the termination of the lease.

(f) The tenant agreed to make all exterior and interior repairs during the term.

On or about May 1, 1947, demolition of the existing improvements was begun by the G. C. Murphy Company and was immediately followed by construction of one department store building on all of the several demised properties. This building, consisting of a basement and five stories, was completed on or about July 1, 1948, at a total cost of $1,442,969. The estimated useful life of the building is 50 years from July 1, 1948.

The estimated cost of the building in so far as it was constructed on Gazelle K. Millhiser's property was from $150,000 to $180,000 and it was borne by the tenant, except to the extent of any salvage value recovered by the tenant from the demolished building thereon.

The cost to Gazelle K. Millhiser of the improvements upon the demised property at the time of their demolition on May 1, 1947, after depreciation was $6,200. She claimed for income tax purposes on account of depreciation of the demolished improvements a deduction at the rate of $240.77 annually from May 1, 1947, until her death.

Gazelle K. Millhiser died on August 31, 1953, while a resident of the City and State of New York, and her will was duly admitted to probate in the Surrogate's Court of the County of New York on September 14, 1953. The will nominated decedent's son, E. Ross Millhiser, as executor and directed that the residue of the estate, after gifts of tangible personal property, be divided into two parts, one of which was $275,000 greater than the other. The larger of the two parts was devised and bequeathed to E. Ross Millhiser as trustee, for the benefit of petitioner for life (the net annual income to be paid to her in quarterly or more frequent installments) and remainder to her children, with authority in the trustee, "in his uncontrolled discretion" to pay principal for the benefit of the life beneficiary or her children. In dividing the estate the executor was authorized to allocate assets in kind at the value of such assets as of the date of testator's death.

E. Ross Millhiser qualified as executor and trustee under said will and it is stipulated here that pursuant to the authority conferred upon him by the will the executor allotted the real property known as 409 East Broad Street, Richmond, Virginia, to that part of the residuary estate devised and bequeathed in trust for petitioner. In the Federal estate tax return the above property was described and appraised as follows:

No. 409 East Broad Street, Richmond, Virginia, approximately 19.2 feet by 142.5 feet upon which other property not owned by deceased a department store has been built. Current annual gross rental $13,750. Owner's share of annual real estate taxes $2,445.19. Of appraisal $200,000.

The Federal estate tax was paid upon the above appraised value of $200,000. E. Ross Millhiser, as trustee, paid petitioner, who resides at the Hotel Surrey in New York, the annual income as computed by him since August 31, 1953. E. Ross Millhiser also, as petitioner's attorney in fact, filed income tax returns for petitioner for the years in question with the district director of internal revenue for the district of Virginia at Richmond. These returns report as income the net rents from 409 East Broad Street, which was computed by E. Ross Millhiser as trustee, as follows:

	1953	1954	1955
Gross rents	$4,583.32	$17,422.61	$17,422.31
Less:			
Real Estate Taxes		6,118.56	6,118.22
Insurance	7.54	12.32	93.59
Commissions	275.00	825.00	825.00
Depreciation	1,666.67	5,000.00	5,000.00
Net rents	$2,634.11	$ 5,466.73	$ 5,385.50

Respondent disallowed the deductions for depreciation in the above computations of net income for the years in question thereby increasing the net income distributed and distributable to petitioner from the trust estate by $1,-

666.67 for the year 1953; $5,000 for the year 1954 and $5,000 for the year 1955. The above adjustment gives rise to the entire deficiency determined in respondent's notice of deficiency.

OPINION

In *Albert L. Rowan*, 22 T.C. 865, the taxpayer inherited a one-third interest in property on which a building had been constructed by the lessee under a 66-year lease. We held the taxpayer was not entitled to a depreciation allowance on the building and our opinion reviews earlier opinions of this Court, *Mary Young Moore*, 15 T.C. 906; *Charles Pearson, Jr.*, 13 T.C. 851; and *Charles Bertram Currier*, 7 T.C. 980, where upon similar facts we had reached an opposite result. Our opinions in the *Moore* and *Pearson* cases had been reversed by the Ninth and Fifth Circuits (*Commissioner* v. *Moore*, 207 F. 2d 265, and *Commissioner* v. *Pearson*, 188 F. 2d 72) and in our *Rowan* opinion we stated that we were re-examining our position and we concluded that the cited opinions of the Fifth and Ninth Circuits in the *Pearson* and *Moore* cases, "lay down the correct rule of law" and we specifically overruled our prior opinions in the *Moore*, *Pearson* and *Currier* cases. The rule which we drew from the said Circuit Court decisions was stated in our *Rowan* opinion in the following language:

> The effect of those decisions, as we understand them, especially the decision of the Ninth Circuit in reversing us in *Mary Young Moore*, *supra*, is to hold that in situations such as we have here where the term of the lease extended beyond the useful life of the building and where the taxpayer would not sustain any economic loss as the building wore out and could not sell

her interest in the building apart from the land or the rentals, the value of her interest in the building was zero and she could not take depreciation on the building.

We applied the rule in the *Rowan* case, stating:

> What Ellen Rowan was receiving at the time of her death was ground rental of $16,500. She was receiving no rental from the building; she had no investment in the building. Ground rental was all that the heirs of Ellen Rowan, including petitioner, received from the property. During the taxable years they were not receiving any rental income from the building itself. The rental income from the building was being received by the lessee who had erected the building on the leased land at his own expense. The leassee was the one to whom annual depreciation deductions on the cost of the building were properly granted. ***

Petitioner argues the instant case is not within the rule of the *Rowan* case; that the case only holds no depreciation will be allowed when the term of the lease extended beyond the useful life of the building. Here the term of the lease will not be expected to extend beyond the useful life of the building.

Any deduction for depreciation must be under section 23 (l), Internal Revenue Code of 1939, and section 167, Internal Revenue Code of 1954. The statutes allow as a depreciation deduction, a "reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—(1) of property used in the trade or business, or (2) of property held for the production of income."

As stated in *Commissioner* v. *Moore, supra*:

> The statutory allowance is available to him whose interest in the wasting asset is such that he would suffer an economic loss resulting from the deterioration and physical exhaustion as it takes place. ***

Petitioner in the instant case had no interest in the building gained by her inheritance of the interest in the land plus the right of reversion at the end of the lease that would suffer an economic loss by reason of the physical wasting of the building during the three years in question.

In *Goelet* v. *United States,* (S.D., N.Y. 1958) 161 F. Supp. 305, it fairly appears that the useful life of the lessee constructed building would extend beyond the end of the lease. In denying the claim of the devisees of the lessor, for depreciation, the Court stated:

> Plaintiffs inherited the fee subject to the lease, the right to receive the ground rentals reserved by the lease, and a reversionary interest in the building itself. Their interest in the building is restricted to a right to occupy it some 32 years after the crucial date in 1941. It is plain that such right suffers no diminution in value as a result of the passage of time; on the contrary, the value of the right must increase as the time for its actual enjoyment advances. This reversion is the only interest which plaintiffs have in the building as such; and as pointed out above, it is not depreciable.

Upon appeal to the United States Court of Appeals, Second Circuit, the above case was affirmed (266 F. 2d 881), the opinion rejecting the very contention here made

that the case is distinguishable from such cases as *Commissioner* v. *Moore*, *supra*, and *Commissioner* v. *Pearson*, *supra*. The Court then goes on to say:

> Appellants fail to show how a depreciable interest in the building was supplied to them in the taxable years by the circumstance that prior to 1946, when the lease term was extended for an additional ten years, the estimated useful life of the building extended eight years beyond the original term of the lease. ***

We hold respondent was right in disallowing the claimed deductions for depreciation.

Petitioner's alternative argument is that she should be allowed a deduction in the tax years representing the amortization of the capitalized value of what is to be considered a favorable lease. This argument is based upon the proposition that the lease is a separable property interest which is to be valued separately at the date of lessor's death and the difference between the high rentals being paid under the lease and those which could then be obtained in the market, sometimes called premium value, should be amortized over the remaining term of the lease.

We rejected the same argument here made in cases with similar facts in *Milton H. Friend, et al., Trustees*, 40 B.T.A. 768, affd. 119 F. 2d 959 (C.A. 7, 1941), certiorari denied 314 U.S. 673, and *Mary Young Moore*, 15 T.C. 906, reversed on this point, 207 F. 2d 265 (C.A. 9, 1953), certiorari denied 347 U.S. 942. In both cases we held that the difference between the total rentals payable under the unexpired term of the lease and the estimated fair rental value for the term was not amortizable over the remaining

life of the lease. Cf. *Martha R. Peters*, 4 T.C. 1236. In our opinion in the *Moore* case, we cited our earlier opinion in *Milton H. Friend, et al., Trustees, supra*, and the affirming opinion of the Seventh Circuit in that case, and stated:

> What petitioner inherited from her mother was an undivided half interest in the land under the Barker Bros. Building and a reversionary interest in the building. Petitioner has attempted to separate the right to receive rent from the bundle of rights possessed by the holder of the fee. The right to receive rent under the lease to which the land was subject at the time of her mother's death was merely incident to the ownership of the fee. The lease grew out of the land, is reflected in the value of the land, and it neither constitutes a separate capital asset, nor increases the value of the building.

In the opinion of the Ninth Circuit in *Commissioner* v. *Moore, supra*, reversing our opinion in *Mary Young Moore, supra*, on this point, the Court noted its disagreement with the opinion of the Seventh Circuit in *Friend* v. *Commissioner, supra.*

It is conceded decedent could not amortize any favorable features of the lease during her lifetime. We see no justification for the separability of the favorable lease value from the many elements that determine the entire value of realty. It was apparently held in *Commissioner* v. *Moore, supra*, that there is no difference between a transfer by death or purchase: that the devisee of the land is to be considered a purchaser of the lease paying "a bonus or premium for the acquisition of the 'favorable' features of the lease", which he should be allowed to recover as his "investment"

in the property by depreciating a portion of the rents he will receive over the remaining period of the lease.

If the purchaser would be entitled to isolate the lease from the fee and take deductions for the favorable portion of the lease, it means some of the rents reserved in the lease would escape ordinary income taxation altogether. This is so because the seller of favorably leased property is entitled to treat the sale as a single transaction or the sale of a single asset with the lease merged in the fee subject to capital gains treatment. If it is logical to say an amount of rent due under the lease, which is considered in excess of normal rent, can be deducted by the purchaser of the favorably leased realty, then it would be equally logical to say the seller should be forced to isolate this amount of rent due under the lease and take it into his ordinary income.

We think the sound solution is to treat the lease interest as merged into the fee. We have not detailed the testimony of the expert who first gave his opinion as to the value of the land, then his opinion as to the normal rental for the property on August 31, 1953. From these figures he arrived at a conclusion that the premium value of the lease on the date of decedent's death was $38,685. We hold that the fact, if it be a fact, that the property was advantageously rented at the date of decedent's death, does not give raise to any claim for deduction for amortization or depreciation of the capitalized value of excess rentals over what might be considered market rentals, on the date of decedent's death. In so holding we follow our opinion in *Milton H. Friend, supra*, and its affirmance by the Seventh Circuit in *Friend* v. *Commissioner, supra*.

Petitioner argues any deficiency for 1953 is barred by section 275 (b), Internal Revenue Code of 1939, which provides, as follows:

SEC. 275. PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION.

Except as provided in section 276—

* * *

(b) Request for Prompt Assessment.—In the case of income received during the lifetime of a decedent, or by his estate during the period of administration, or by a corporation, the tax shall be assessed, and any proceeding in court without assessment for the collection of such tax shall be begun, within eighteen months after written request therefor (filed after the return is made) by the executor, administrator, or other fiduciary representing the estate of such decedent, or by the corporation, but not after the expiration of three years after the return was filed. This subsection shall not apply in the case of a corporation unless—

(1) Such written request notifies the Commissioner that the corporation contemplates dissolution at or before the expiration of such 18 months' period; and

(2) The dissolution is in good faith begun before the expiration of such 18 months' period; and

(3) The dissolution is completed.

The executor made and filed with the Commissioner the written request for prompt assessment of income tax. The record does not show the date of the request. The executor was asked if any "assessment for the year 1953 [was] made within 18 months following that requested assessment or adjustment or any phase of it," and he answered "No." We do not know whether he meant an assessment against the estate or petitioner for 1953 income. At any rate, it is clear the statute merely limits time for an assessment of income tax for income received by a decedent in his lifetime or by his estate during the period of administration. It does not limit the time of assessment of a deficiency in the individual return of a taxpayer.

Reviewed by the Court.

Decision will be entered for the respondent.

OPPER, J., dissenting:

I.

As I read the present Opinion, the real problem involved is not discussed. It arises as a question of recovery of basis and the nearest approach to suggesting that there is any such difficulty, is the decision here of an issue—not before us—as to what depreciation may be deducted by an imaginary purchaser of improved real property who paid more for it than he would for vacant land even though he did not thereby acquire title to the improvement.

It is presumably being held, gratuitously it seems to me, that when the improvement finally becomes worthless, or the valuable lease covering it comes to an end, and the

real property reverts to the unimproved value it would have had without the improvement and lease in the first place, the consequent loss must either be taken all in 1 year, or possibly, since the Opinion is obscure as to this, that it may never be taken at all. No cases are cited for this treatment and the authorities seem to me to be to the contrary.

II.

A somewhat similar situation was presented in *Millinery Center Building Corp.*, 21 T.C. 817. There, the purchaser of the fee happened to be the tenant who had constructed the building but whose cost thereof had been fully depreciated. In order, as it insisted, to rid itself of a burdensome lease, it purchased the fee with whatever rights its landlord might have in the building. In denying to it any deduction for depreciation or amortization, we said, as the present Opinion says: "We think that the bundle of rights which petitioner acquired by its contract of purchase * * * was so inextricably entwined in the acquiring of the land, as not to be separable therefrom." Six judges dissented. On appeal, the case was reversed (C.A. 2) 221 F. 2d 322. The Court of Appeals said, among other things:

> Petitioner's main argument throughout this litigation has been that the difference between the purchase price of $2,100,000 and the unimproved value of the land, $660,000, namely the sum of $1,440,000, should be deductible * * *. [I]t suggested amortization of this amount over the unexpired term of the lease, or its depreciation as an additional cost of acquiring the already fully depreciated building.

The Appellate Court refused to allow the deduction as an ordinary and necessary expense and pointed out that there, the lease having merged with the fee, there could be no amortization of it. But it said (p. 324):

> But the dissent seems more in accord with the realities of this situation. The taxpayer in acquiring this fee bought not only a reversionary interest in the land itself, but also a reversionary interest in the building which under the lease it would have to surrender to the landlord when its term expired. *A third-party purchaser of such a fee would be entitled to allocate part of its cost to the building and to depreciate it as such.* [Emphasis added.]

The case went to the United States Supreme Court (350 U.S. 456) which affirmed the reversal by the Court of Appeals, saying (p. 460, 461):

> Petitioner's claim that it "owned" the building is based on a loose and misleading use of "owned." * * * It could make use of the building for the remainder of its economic life, but only on payment of the stated rent. * * * A complementary feature of the purchase of the lessor's interest in the land and building was the elimination of the obligation to pay rent on the improved land. *The purchase price presumably reflected this situation.* * * *
>
> * * * Petitioner has acquired two assets—land and a building—whose use it will have for the remainder of their useful lives, and petitioner therefore cannot amortize the cost allocable to the acquisition of the wasting asset over the term of the extinguished lease.

> Accordingly, we affirm the judgment * * * leaving to the Tax Court the allocation still to be made. [Emphasis added.]

It would seem to follow that if a third person rather than Millinery Center had purchased the fee, two other consequences would ensue. Its purpose for the purchase would not be like *Millinery Center* to eliminate a burdensome lease but to acquire the benefit of the collection of a favorable rental; and it could not be said, as it was in *Millinery Center,* that the lease having merged with the fee, no deduction for amortization of the lease would be permissible. Some method of compensating the purchaser for the excess payment, corresponding in the *Millinery Center* case to $1,440,000, would have to be found to reconcile the decision there with that in the *Millinery Center* case.

Another example is the case of *Buckermann* v. *United States,* (C.A. 8) 155 F. 2d 597, upon which we relied in *Charles Bertram Currier,* 7 T.C. 980. There, land upon which the building did not then belong to the owner of the fee was inherited, and as the Court there notes (p. 600):

> [F]or the purpose of the Federal estate tax the estate's interest in the land, *and in the building on the land,* the property in which taxpayer acquired a share by devise, was valued at $100,000. * * *
>
> [A]n expert witness familiar with the land before the erection of the building testified that its value as vacant property at the time of the execution of the lease was $50,000. [Emphasis added.]

See also *Frieda Bernstein,* 22 T.C. 1146, affirmed per curiam (C.A. 2) 230 F. 2d 603.

III.

When real property is acquired by devise it assumes a new basis in the hands of the devisee, consisting of fair market value at decedent's death and established primarily for estate tax purposes. Of course, this will ordinarily be different from decedent's basis, and what he could or could not recover would be quite different. But it is similar to the basis of cost established by an acquisition by purchase, and gain or loss on final disposition by the devisee, just as by the purchaser, will be measured by his own basis. This, as I read it, is what the Court of Appeals had in mind in *Commissioner* v. *Moore*, (C.A. 9) 207 F. 2d 265, reversing 15 T.C. 906, certiorari denied 347 U.S. 942.

Now it would be miraculous if, for estate tax purposes, respondent should value unimproved, unproductive land by the same formula as property producing a substantial net long-term income.[1] We know from petitioner's evidence that here, in fact, the values were different.[2]

The situation is brilliantly illustated by the case of *Albert L. Rowan*, 22 T.C. 865, 870. There the Tax Court's findings were:

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[1] In *Albert L. Rowan*, 22 T.C. 865, 873, we said: "It seems plain that in the instant case the Commissioner in valuing the interest of Ellen Rowan in the Gulf States Building property at $412,500 did so solely by capitalizing the ground rental of $16,500 at 4 per cent for the remaining term of the lease. * * *" This, of course, would have been an impossible procedure as to vacant and unproductive land.

[2] Of course, the question is purely theoretical in a specific case since it would be impossible to find an instance of two exactly identical pieces of real property, one improved and the other vacant. All that can be done is what was attempted here—a comparative valuation by an opinion witness.

The fair market value of the * * * property * * * *without taking into consideration the outstanding lease* on the property was as follows:

Land	$300,000
* * *	

The fair market value of Ellen Rowan's [decedent's] entire interest in the * * * property on June 20, 1940 [the date of death], *that is to say including her interest in the land, building, and the lease, was $412,500. The Commissioner in arriving at this valuation for estate tax purposes * * * did so without ascribing any valuation to* [decedent's] *reversionary interest in the land and building at the end of the term of the lease. His valuation was based upon capitalizing the annual rental * * **. [Emphasis added.]

There was thus a difference between the bare land value[3] and decedent's interest, which of course the taxpayer in the *Rowan* case partly inherited, of $112,500.

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[3] It is true that in *Commissioner* v. *Pearson*, (C.A. 5) 188 F.2d 72, reversing 13 T.C. 851, certiorari denied 342 U.S. 861, which happened to involve the same property as *Rowan*, the Court assumed that the estate tax valuation was for the land only and that this is accepted in *Commissioner* v. *Moore*, *supra*, where, referring to the *Pearson* case, the statement is made (p. 270):

> It is true that under the facts of that case it appeared from the record that the sum of $412,500, fixed as the value of the ancestor's interest in the property for estate tax purposes, had been based upon the value of the land alone. *That fact made the case an easy one to decide.* [Emphasis added.]

But on the more amplified record in the *Rowan* case as detailed above these factual statements were—although understandably—in error. And in the *Pearson* case, had the valuation been based upon the value of the land alone, it would have been $300,000 and not $412,500.

This difference in value, which will disappear with the improvement and the lease when the real property reverts to its unimproved valuation, should be recovered over the life of one or the other. Otherwise what is really a return of basis will appear to be taxable income. The *Rowan* case was, however, probably decided correctly, since the present issue and the one raised in the *Moore* case was for some reason not there presented.

IV.

We tried to meet this over-all problem in *Charles Bertram Currier, supra,* where, for want of a better approach, a part of the devisee's basis was assumed to be in the building, even though he did not own it. In this we were mistaken, as witness the Courts of Appeals of the Fifth and Ninth Circuit, although in *Commissioner* v. *Pearson,* 188 F. 2d 72, reversing 13 T.C. 851, certiorari denied 342 U.S. 861, the Court of Appeals for the Fifth Circuit specifically refrained from repudiating the doctrine of the *Currier* case. But what is of real significance here is that the only other reversal, *Moore,* sought to solve the obvious problem by the very means which the present Opinion rejects, namely, to incorporate in the total value some element for the lease itself which will eventually terminate and for which depreciation should accordingly be available. The problem has not been illuminated by the failure of the Supreme Court to grant certiorari in *Moore,* which appears to present an irreconcilable conflict with *Friend* v. *Commissioner,* (C.A. 7) 119 F. 2d 959, affirming 40 B.T.A. 768, certiorari denied 314 U.S. 673.

It seems to me to be of little consequence whether the asset being permitted to justify depreciation, or, if you prefer,

amortization, is stated to be the interest in the building, the lease, or some other intangible which is either different or a combination of the two. The inescapable economic fact is that the estate tax was paid on a higher value because the property was improved and leased; that this differential will eventually disappear; and that some consideration must necessarily be given it.

There is a suggestion in *Pearson* that what has been said about a basis for gain or loss would not apply to this situation because we are concerned here with basis for depreciation. See *Buckermann* v. *United States, supra*. This proposition, which also appears in *Friend* v. *Commissioner, supra*, is, we think, set at rest by the statement in *Commissioner* v. *Moore, supra* at 275:

> What we have said discloses that we do not agree with the quoted statement. We think that the court there failed to note that Sec. 114(a) provides that the basis for depreciation is the same basis provided in Sec. 113.

For the reason that in my opinion some consideration must be given to the excess value incorporated in the estate tax appraisal and that some depreciation thereon should be computed, I respectfully note my dissent.

DRENNEN, J., agrees with this dissent.

STATUTES INVOLVED

Internal Revenue Code of 1954:[1]

SEC. 161. ALLOWANCE OF DEDUCTIONS.

In computing taxable income under section 63(a), there shall be allowed as deductions the items specified in this part, subject to the exceptions provided in part IX (sec. 261 and following, relating to items not deductible).

(26 U.S.C. 1958 ed., Sec. 161.)

SEC. 167. DEPRECIATION.

(a) General Rule.—There shall be allowed as a depreciation deduction a reasonbale allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business, or

(2) of property held for the production of income.

* * * * *

(f) Basis for Depreciation.—The basis on which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 1011 for the purpose of determining the gain on the sale or other disposition of such property.

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[1] The corresponding provisions of the Internal Revenue Code of 1939 (Sections 23(l) and (n), 113(a)(5), 113(b), and 114(a)), applicable here to the year 1953, are to like effect.

(g) Life Tenants and Beneficiaries of Trusts and Estates.—In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant. In the case of property held in trust, the allowable deduction shall be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each. In the case of an estate, the allowable deduction shall be apportioned between the estate and the heirs, legatees, and devisees on the basis of the income of the estate allocable to each.

(26 U.S.C. 1958 ed., Sec. 167.)

SEC. 1011. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis (determined under section 1012 or other applicable sections of this subchapter and subchapters C (relating to corporate distributions and adjustments), K (relating to partners and partnerships), and P (relating to capital gains and losses)), adjusted as provided in section 1016.

(26 U.S.C. 1958 ed., Sec. 1011.)

SEC. 1014. BASIS OF PROPERTY ACQUIRED FROM A DECEDENT.

(a) In General.—Except as otherwise provided in this section, the basis of property in the hands of a person acquiring the property from a decedent or to whom the property passed from a decedent shall, if not sold, exchanged, or otherwise disposed of before the decedent's death by such person, be the fair market value of the property at the date of the decedent's death, or, in the case of an election under either section 2032 or section 811(j) of the Internal Revenue Code of 1939 where the decedent died after October 21, 1942, its value at the applicable valuation date prescribed by those sections.

(b) Property Acquired from the Decedent.—For purposes of subsection (a), the following property shall be considered to have been acquired from or to have passed from the decedent:

(1) Property acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent;

* * * * * *

(26 U.S.C. 1958 ed., Sec. 1014.)